

Internal Revenue Service

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B01

PLR-137544-09

Date:

January 11, 2010

Legend

X =

A =

Trust 1 =

Trust 2

Trust 3

State =

Year =

Date 1 =

Dear :

This responds to a letter dated July 31, 2009, submitted on behalf of X from X's authorized representative, requesting inadvertent termination relief pursuant to § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State in Year and elected to be treated as an S corporation effective Date 1. On Date 1, the shareholders of X included Trust 1, Trust 2, and Trust 3 (together, the Trusts).

Under the terms governing each of the Trusts, the sole beneficiary of each of the Trusts was A or A and his spouse. X represents that each of the Trusts satisfied the requirements to be a qualified subchapter S trust (QSST) enumerated in § 1.1361-1(j)(6)(ii)(E) on Date 1 and at all times thereafter. However, the beneficiary of Trust 1 and Trust 2 failed timely to file a QSST election for Trust 1 and Trust 2. Further, the trustee of Trust 1 and Trust 2, rather than the beneficiary, signed the consent on Form 2553, Election by a Small Business Corporation. Further, A's spouse did not sign a shareholder consent on behalf of Trust 3, and failed to sign the QSST election for Trust 3. Therefore, X's S corporation election was not effective on Date 1.

X represents that A and his spouse reported their allocable shares of the Trusts' income on all affected returns consistent with the treatment of the Trusts as QSSTs. X further represents that X filed as an S corporation for all years from and after Date 1. X represents that the circumstances resulting in the termination of X's S corporation election were inadvertent and were not motivated by tax avoidance or retroactive tax planning.

Law and Analysis

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1361(a)(1) provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1)(B) provides that the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not have as a shareholder a person (other than an estate, a trust described in §1361(c)(2), or an organization described in §1361(c)(6)) who is not an individual.

Section 1361(c)(2)(A)(i) provides that for purposes of § 1361(b)(1)(B), a trust all of which is treated (under subpart E of part I of subchapter J of Chapter 1) as owned by an individual who is a citizen or resident of the United States may be a shareholder.

Section 1361(d)(1) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2) -- (A) such trust shall be treated as a trust described in § 1361(c)(2)(A)(i) and, (B) for purposes of § 678(a), the beneficiary of such trust shall be treated as the owner of that portion of the trust which consists of stock in an S corporation with respect to which the election under § 1361(d)(2) is made.

Section 1361(d)(2)(A) provides that a beneficiary of a QSST (or his legal representative) may elect to have § 1361(d) apply. Section 1361(d)(2)(D) provides that an election under § 1361(d)(2) shall be effective up to 15 days and 2 months before the date of the election.

Section 1361(d)(3) provides that, for purposes of § 1361(d), a QSST means a trust (A) the terms of which require that (i) during the life of the current income beneficiary there shall be only 1 income beneficiary of the trust, (ii) any corpus distributed during the life of the current income beneficiary may be distributed only to such beneficiary, (iii) the income interest of the current income beneficiary in the trust shall terminate on the earlier of such beneficiary's death or the termination of the trust, and (iv) upon the termination of the trust during the life of the current income beneficiary, the trust shall distribute all of its assets to such beneficiary, and (B) all of the income (within the meaning of § 643(b)) of which is distributed (or required to be distributed) currently to 1 individual who is a citizen or resident of the United States.

Section 1.1361-1(j)(2)(i) of the Income Tax Regulations provides that, if a husband and wife are income beneficiaries of the same trust, the husband and wife file a joint return, and each is a U.S. citizen or resident, the husband and wife are treated as one beneficiary for purposes of § 1.1361-1(j). If a husband and wife are treated by the preceding sentence as one beneficiary, any action required by § 1.1361-1 to be taken by an income beneficiary requires joinder of both of them. For example, each spouse must sign the QSST election.

Section 1.1361-1(j)(6)(ii) provides that the current income beneficiary of the trust must make the election under § 1361(d)(2) by signing and filing with the service center with which the corporation files its income tax return the applicable form or a statement including the information listed in § 1.1361-1(j)(6)(ii).

Section 1362(f) provides, in part, that if (1) an election under §1362(a) by any corporation was not effective for the taxable year for which made by reason of a failure to meet the requirements of §1361(b), (2) the Secretary determines that the circumstances resulting in such ineffectiveness were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such ineffectiveness, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to §1362(f), agrees to make adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in such ineffectiveness, such corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the information submitted and the representations made, we conclude that X's S corporation election was ineffective for the taxable year beginning on Date 1 because the Trusts were ineligible shareholders of X due to the failures to make QSST elections and to consent to the S corporation election on behalf of the Trusts. We also conclude that the ineffectiveness of X's S corporation election was inadvertent within the meaning of § 1362(f). Therefore, X will be treated as an S corporation from Date 1 and thereafter provided that X's S corporation election was otherwise valid and has not otherwise terminated under §1362(d).

This ruling is conditioned on the beneficiary or beneficiaries of each of the Trusts filing shareholder consents to X's S corporation election with the appropriate service center, indicating that the consents are to be associated with the originally filed Form 2553, within 60 days of this letter.

Additionally, during the ineffectiveness period and thereafter, the Trusts will be treated as QSSTs described in § 1361(d)(3) (assuming the trusts otherwise qualify as QSSTs), and A, or A and his spouse as the case may be, will be treated as the owner of the X stock held by each of the Trusts, provided that A, or A and his spouse as the case may be, files QSST elections effective Date 1 with the appropriate service center within 60 days following the date of this letter. A copy of this letter should be attached to the consents and to the QSST elections.

Except as expressly provided herein, we express or imply no opinion concerning the federal tax consequences of the transactions described above under any other provision of the Code. Specifically, no opinion is expressed or implied concerning whether X is otherwise eligible to be treated as an S corporation, or whether the Trusts are otherwise eligible to be QSSTs under § 1361(d)(3).

This ruling letter is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file with this office, a copy of this letter is being sent to X's authorized representative.

Sincerely,

David R. Haglund

David R. Haglund
Chief, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

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